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"As to losses on stocks, grains, cotton, etc., if these are incurred by a person engaged in trade, to which the buying and selling of stocks, etc., are incident as a part of the business, as by a member of a stock, grain, or cotton exchange, such losses may be deducted."<sup>19</sup>

In these decisions, the Treasury Department has used "business" and "trade" as correlative terms, but the interpretation placed upon them is "*his business*", thereby denying the broad signification of the term and adopting the restricted legal meaning. The court in the instant case upheld these decisions as correctly construing the legislative intent of Congress.<sup>20</sup>

The decision in the instant case was made in total disregard of new light shed upon the legislative intent of Congress in the use of the term "trade" by recent amendments to the Income Tax Act. Congress, evidently awakened to a realization of the ambiguity of the term "trade", put to rest any doubt there may have been as to its legislative intent by inserting in the section of the original act dealing with allowed deductions in computing net incomes the following provision:<sup>21</sup>

"\* \* \* Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; \* \* \*." (Italics supplied.)

Whether this amendment to the Income Tax Act is declaratory of the intention of Congress that the term "trade" be construed in its broadest signification is now immaterial. It is enough that this amendment is positive law, and the failure of the court in the instant case to allow the taxpayer, in computing his taxable income, to deduct losses actually sustained through transactions entered into for profit, though not connected with his regular business, is in distinct derogation of the law.

F. S. T., JR.

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ARE STOCK DIVIDENDS INCOME?—The Sixteenth Amendment to the Constitution of the United States provides that Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration. In pursuance of this Amendment, Congress enacted that stock div-

<sup>19</sup> Treasury Department Decision No. 2090.

<sup>20</sup> *Mente v. Eisner, supra*. It is to be regretted that, in framing a statutory provision of as much importance as the Income Tax Act, a term so vague and admitting of such variety of signification has been employed.

<sup>21</sup> Federal Revenue Act of 1918, approved Feb. 24, 1919, Title II, Part II, § 214, subd. 5. U. S. Comp. St. Supp. 1919, § 6336½g.

idends should be taxed as income, without apportionment of the tax according to population.<sup>1</sup>

The question as to the nature of stock dividends has been the subject of much discussion among contemporary economists. Various opinions have been vouchsafed, and there seems to be no way of reconciling the different views set forth.

Mr. Zuckerman, in a very astute discussion of the proposition,<sup>2</sup> divides stock dividends into two classes: first, "dividends based upon increased valuations placed upon good-will in a re-appraisal of the assets as a result of the increased earning power of the corporation without additional investment"; and second, "those based upon the additional investment of accumulated profits for the purpose of extending its operations". According to this author, the former may logically be exempted; the latter should be taxed as income.

In classing the second variety of stock dividends as taxable income, reliance is put chiefly upon three arguments. First, it is contended that the corporation and the stockholders are one and inseparable; hence, what is income to the former is of necessity income to the latter. In the second place, it is attempted to show that stock dividends are in reality a realization and re-investment of income. Finally, it is argued that the practical effect of declaring stock dividends not income is such as materially to embarrass the taxing power of the Federal Government by allowing the evasion of the tax laws by the manipulation of stock dividends so as to deal in other stocks and effect mergers of different corporations.

It is quite evident that the first class of stock dividends is not income and can not be taxed as such. Two, at least, of the reasons presented for holding the second class income seem to be answered in a thorough discussion of the question by Mr. Seligman.<sup>3</sup> It is there shown that accretions to capital are not economically income unless they have been separated and realized. The mere fact that the gains are separable and realizable is not sufficient. As pointed out, "inchoate gains are not income". Furthermore, the dangerous opportunity afforded to deal in the stock of other corporations and to effect mergers thereby is briefly answered by showing that such dividends would be, as to the individual, *realized* income and taxable as such.

Corporations are, in their nature, creatures of law, sanctioned and controlled by the law. A corporation is in essence a juridical entity separate and distinct from the members who compose it. It is treated as such very generally, and it seems that the legal fiction of the separation of the corporation from the shareholders is more emphasized in relation to the income tax than in any other case. The same income is taxed to the corporation as a distinct unit, and again to the shareholders. There is really

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<sup>1</sup> Revenue Act, Sept. 8, 1916, c. 463, § 2 (Comp. St. § 6336b).

<sup>2</sup> JOURNAL OF POLITICAL ECONOMY, July, 1920.

<sup>3</sup> THE AMERICAN ECONOMIC REVIEW, Sept., 1919.

more truth than fiction in such a separation. As pointed out by Mr. Justice Pitney,<sup>4</sup> unless there is liquidation or a declaration of cash dividends by the corporation, through its officers, a stockholder may not withdraw any part of either capital or profits from the enterprise; his interest not pertaining to any part, divisible or indivisible, but to the entire assets, business, and affairs of the company.

The question was presented very clearly to the Supreme Court,<sup>5</sup> and it was there decided, four judges dissenting, that stock dividends are not income to the individual. This decision has for its basis several decided cases.<sup>6</sup> Also, the decision was reached only after a careful survey and discussion of the economic principles involved. The court, speaking through Mr. Justice Pitney, declared that stock dividends are not an increase of property, but are simply a book-keeping device for adjusting the books of the corporation so as to transfer the "surplus" account to the "capital stock" account, thus permanently tying the profits up in the business.<sup>7</sup> There is *in fact* no income acquired by the receipt of a stock dividend.<sup>8</sup> But the power to tax "income" is derived from the Constitution, and no Constitutional Amendment, nor any Act of Congress, nor any decision of the Supreme Court can make stock dividends income if they are not such *in fact*,<sup>9</sup> nor prevent them from being income if they are in fact income. Therefore, it would seem that the Supreme Court has decided the question in accord with the soundest principles of economics as well as upon the precedent of previous cases.

E. M. P.

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THE BEARING OF THE SIXTEENTH AMENDMENT ON THE POWER OF CONGRESS TO TAX ANY INCOME REGARDLESS OF ITS SOURCE.—  
The Sixteenth Amendment, passed as a result of the decision in

<sup>4</sup> *Eisner v. Macomber*, 40 Sup. Ct. 189, 193.

<sup>5</sup> *Eisner v. Macomber*, *supra*.

<sup>6</sup> *Spooner v. Phillips*, 24 Conn. 524; *Gibbons v. Mahon*, 136 U. S. 549; *Towne v. Eisner*, 245 U. S. 418.

<sup>7</sup> *Eisner v. Macomber*, 40 Sup. Ct. 189, 194.

<sup>8</sup> *Eisner v. Macomber*, *supra*. "A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interests of the shareholders. Its property is not diminished, and their interests are not increased. \* \* \* The proportional interest of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original shares together representing the same proportional interest that the original shares represented before the issue of the new ones." *Gibbons v. Mahon*, 136 U. S. 549, 559, 560.

For example: A shareholder owns 10 shares of stock of the par value of \$100 each, and proportional to the shares there is a surplus of \$500. Then he has 10 shares of the total worth of \$1500. Suppose the corporation to declare a stock dividend of 50%. Then the shareholders would own 15 shares of stock worth \$100 each, or a total still of \$1500, no increase or income having resulted.

<sup>9</sup> *Towne v. Eisner*, *supra*.